In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 839

HENRY VAN HUMMELL, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The question presented is whether petitioner, a closely held family corporation, is for the years 1956 through 1959 liable for the accumulated earnings tax imposed upon corporations which accumulate earnings in order to avoid income tax on their stockholders. 1954 Code §§ 531–537.

Petitioner sold and serviced renewable group life insurance policies to approximately 80,000 members of the Federal Postal Employees Association (FPEA). It collected the premiums from the members and remitted them to the insurance company which had written the group life insurance policy. Its principal income came from the annual mortality refund from the insurer, representing the difference between the total premiums received by the insurer,

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on the one hand, and the total claims, commissions and other expenses of the insurer, on the other. In the event claims in any year exceeded premiums, the insurance carrier reserved the right to deduct the excess from future mortality refunds. During 1956 through 1959, the mortality refund constituted about seventy percent of petitioner's income; without it petitioner would have operated at a deficit. (Pet. 14; R. 57–60, 66–67, 74–75, 84.)

The Tax Court found, in accord with the Commissioner's determination, that during the taxable years 1956–1959 petitioner had accumulated $491,700 of earnings beyond the reasonable needs of its business and that it had not demonstrated the absence of a purpose to avoid the income tax with respect to its shareholders (R. 61, 65, 91). The court of appeals affirmed (Pet. 19).

The decision below is correct, there is no conflict of appellate decisions or other reason for further review of the essentially factual questions presented.

1. The Code imposes a tax upon a corporation which accumulates earnings for the purpose of avoiding the imposition of income tax upon its shareholders. 1954 Code §§ 531–532. (App. *infra*, p. 7). In general, the tax is a percentage of earnings accumulated in excess of the reasonable needs of the business. Code §§ 531, 535 (App. *infra*, 7, 8). The Code provides that if a corporation accumulates earnings not reasonably needed in its business, the corporation shall be liable for the tax unless it proves by the preponderance of the evidence that the purpose of the accumulation was not to avoid income tax on its stockholders. Code § 533 (App. *infra*, pp. 7–8). Whether an accumulation ex-

ceeds the corporation's reasonable business needs (and is therefore presumed to have been accumulated for the proscribed purpose) is a question of fact, and the trial court's findings are conclusive if supported by the evidence. *Helvering* v. *Stock Yards Co.*, 318 U.S. 693, 701–702; *Helvering* v. *National Grocery Co.*, 304 U.S. 282, 295.

Here the Tax Court, upon the basis of undisputed subsidiary findings, found that petitioner permitted its earnings in each of the years in question to accumulate beyond the reasonable needs of its business and, upon a careful analysis of petitioner's evidence, concluded that petitioner had failed to demonstrate by a preponderance of the evidence that the purpose of the accumulation was not to avoid income tax with respect to its shareholders (R. 70). The court of appeals affirmed. Such findings concurred in by two lower courts are entitled to finality in the absence of an exceptional showing of error. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51; *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

2. The Tax Court carefully considered all of petitioner's contentions concerning the needs of its business during the taxable years. It found that petitioner's net liquid assets (net current assets plus investments not integral to the business) increased from $1,189,000 to $1,536,000 during the years here in question (R. 65). The court also found that neither petitioner's actual nor its anticipated expenditures (including capital outlays) had exceeded $879,000 per year (R. 65). Moreover, petitioner's business was steadily increasing (R. 68, 77), and its fears that a

sharp increase in the mortality rate of FPEA members might wipe out its mortality refund were "groundless, if not imaginary" (R. 75). Thus its available liquid assets greatly exceeded its business needs during all four of the years in issue.

The court of appeals, after a full review of the facts, agreed that "considering all the aspects of petitioner's business, and its uncertainties and hazards as revealed in the record, it cannot be said that the finding of the Tax Court that the accumulation was unreasonable is not properly and fully supported by the record" (Pet. 17).[1]

Petitioner was 95 percent owned by one family and the income tax savings to the family resulting from retention of the unneeded corporate earnings here in question was $309,000 (Pet. 15). Therefore, the lower courts were fully justified in finding (1) that nearly one-half million dollars in earnings was accumulated

[1] After entry of the Tax Court decision, petitioner moved for a new trial, alleging, *inter alia*, that a subsequent decision of a Colorado State arbitrator in an action by FPEA against petitioner conflicted with the Tax Court's findings concerning the risks of the business. In overruling the motion, the Tax Court observed that the controversy with FPEA "did not arise until sometime well after the last tax year involved in this proceeding" and that the hazards presented by the controversy with FPEA were not "seriously considered, planned for or provided for by" petitioner during the years 1956 through 1959 (R. 138). In the circumstances, the Tax Court's action, as the court below noted (Pet. 19), "is clearly within its discretion." *Mensik* v. *Commissioner*, 328 F. 2d 147, 151 (C.A. 7). In any event, while the facts concerning the FPEA suit against petitioner are adverted to in the petition herein, the Tax Court's denial of the motion for a new trial is apparently not seriously relied upon as a reason for the granting of a writ in this case.

during the taxable years in excess of the reasonable needs of the business, and (2) that petitioner had not sustained its burden of proving by a preponderance of the evidence that the purpose for the unreasonable accumulation was not to avoid the income tax on stockholders.

3. The decision below is not in conflict with *Young Motor Company* v. *Commissioner,* 281 F. 2d 488. In that case, decided under the 1939 Code, the Tax Court had held the taxpayer liable for the accumulated earnings tax without deciding whether the earnings which it had accumulated exceeded the reasonable needs of its business. Thus, according to the Tax Court's approach, a corporation would owe the tax on earnings which it had accumulated to meet the reasonable needs of its business, if the corporation also intended to avoid taxes on the stockholders. The First Circuit reversed and remanded for a finding on the reasonable needs of the business.

Under the 1954 Code such a case could never arise. The 1939 Code, under which *Young* arose, did not allow a corporation a deduction against accumulated earnings for those earnings which had been accumulated for the reasonable needs of the business. The 1954 Code, on the other hand, does grant such a deduction. 1954 Code § 535 (App. *infra,* p. 8). Therefore, under the 1954 Code earnings accumulated to meet reasonable business needs are exempt from the tax. In the instant case both lower courts explicitly found that petitioner's earnings were not accumulated to meet

reasonable business needs. Therefore, there is no conflict between the instant decision and Young.

Nor, as petitioner asserts (Pet. 10–11), does the decision below conflict in principle and approach with other cases. Whether accumulations of earnings are reasonable in the light of alleged business needs is a factual issue involving many considerations. Each case turns on its own facts and the trial court's findings should not be disturbed where, as here, the appellate court has approved them after a full review of the record.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 531. IMPOSITION OF ACCUMULATED EARNINGS TAX.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in Section 535) of every corporation described in section 532, an accumulated earnings tax equal to the sum of—

(1) 27½ percent of the accumulated taxable income not in excess of $100,000, plus

(2) 38½ percent of the accumulated taxable income in excess of $100,000.

SEC. 532. CORPORATIONS SUBJECT TO ACCUMULATED EARNINGS TAX.

(a) *General Rule.*—The accumulated earnings tax imposed by section 531 shall apply to every corporation (other than those described in subsection (b)) formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

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SEC. 533. EVIDENCE OF PURPOSE TO AVOID INCOME TAX.

(a) *Unreasonable Accumulation Determinative of Purpose.*—For purposes of section 532, the fact that the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the in-

come tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary.

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SEC. 535. ACCUMULATED TAXABLE INCOME.

(a) *Definition.*—For purposes of this subtitle, the term "accumulated taxable income" means the taxable income, adjusted in the manner provided in subsection (b), minus the sum of the dividends paid deduction (as defined in section 561) and the accumulated earnings credit (as defined in subsection (c)).

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(c) *Accumulated Earnings Credit.*—

(1) *General rule.*—For purposes of subsection (a), in the case of a corporation other than a mere holding or investment company the accumulated earnings credit is (A) an amount equal to such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business * * *.

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